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IN THE

Supreme Court of the United States

OCTOBER TERM, 1982

AMERICAN PAPER INSTITUTE, INC., *Petitioner*,

v.

AMERICAN ELECTRIC POWER SERVICE CORPORATION, *et al.*, *Respondents*.

FEDERAL ENERGY REGULATORY COMMISSION, *Petitioner*,

v.

AMERICAN ELECTRIC POWER SERVICE CORPORATION, *et al.*, *Respondents*.

On Writ Of Certiorari To The United States Court Of Appeals For The District Of Columbia Circuit

BRIEF OF DIAMOND SHAMROCK CORPORATION, HOFFMANN-LA ROCHE INC., MADISON PAPER INDUSTRIES, PARSONS & WHITTEMORE, INC., THE PORT AUTHORITY OF NEW YORK AND NEW JERSEY, UNION OIL COMPANY OF CALIFORNIA AS *AMICI CURIAE* IN SUPPORT OF PETITIONERS

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TABLE OF CONTENTS

	Page
INTERESTS OF *AMICI CURIAE*	2
STATEMENT	6
A. PURPA Section 210	6
1. Provisions In PURPA Section 210 Regarding Purchase And Sale Rules	7
2. Provisions In PURPA Section 210 Regarding Exemptions From Unnecessary Regulation	9
B. Pertinent Rules Promulgated By The Commission Pursuant To The Provisions In PURPA Section 210	10
1. The Interconnection Rule	11
2. The Avoided Cost Rule	11
SUMMARY OF ARGUMENT	14
ARGUMENT	15
I. THE COMMISSION'S RULE REQUIRING ELECTRIC UTILITIES TO MAKE INTERCONNECTIONS NECESSARY TO ACCOMPLISH PURCHASE AND SALE TRANSACTIONS WITH QUALIFYING FACILITIES IS NOT CONTRARY TO THE PROVISIONS IN PURPA SECTION 210	15
II. THE COMMISSION'S RULE REQUIRING THAT A UTILITY'S RATE FOR PURCHASES OF ELECTRICITY FROM NEW CAPACITY MUST EQUAL THE UTILITY'S AVOIDED COST IS FULLY JUSTIFIED AS A RULE WHICH INSURES THAT PURCHASE RATES SHALL NOT DISCRIMINATE AGAINST QUALIFYING FACILITIES AND SHALL BE JUST AND REASONABLE TO ELECTRIC CONSUMERS AND IN THE PUBLIC INTEREST	20
CONCLUSION	30

TABLE OF AUTHORITIES

CASES: Page

American Electric Power Service Corp. v. *FERC*, 675 F.2d 1226 (D.C. Cir. 1982) 20, 21, 22, 25

Batterson v. *Francis*, 432 U.S. 416 (1977) 29

FPC v. *Hope Natural Gas Co.*, 320 U.S. 591 (1944) .. 24

FERC v. *Mississippi*, No. 80-1749 (June 1, 1982), 102 S.Ct. 2126 ..... 5, 6, 7, 8, 9, 19

Metropolitan Dade County and Florida Power & Light Co. v. *The Florida Public Service Commission*, No. 61,536 (Fla., argued October 5, 1982) 3

Permian Basin Area Rate Cases, 390 U.S. 747 (1968) . 29

Red Lion Broadcasting Co. v. *FCC*, 395 U.S. 367 (1969) 16

Train v. *Natural Resources Defense Council*, 421 U.S. 60 (1975) 16

Udall v. *Tallman*, 380 U.S. 1 (1965) 15

Vermont Yankee Nuclear Power Corp. v. *Natural Resources Defense Council*, 435 U.S. 519 (1978) 29

STATUTES:

Federal Power Act, 16 U.S.C. §§ 791a *et seq.* (1976 & Supp. IV 1980):

202(b), 49 Stat. 848 § 213, 16 U.S.C. § 824a(b) 17, 18

§ 210, 92 Stat. 3135, 16 U.S.C. § 824i ... 9, 10, 17, 18, 19

§ 211, 92 Stat. 3137, 16 U.S.C. § 824j ... 9, 10, 17, 18, 19

§ 212, 92 Stat. 3138, 16 U.S.C. § 824k 10, 17, 18, 19

§ 212(e)(1), 92 Stat. 3139, 16 U.S.C. § 824k(e)(1) ...7, 17

§ 212(e)(2), 92 Stat. 3139, 16 U.S.C. § 824k(e)(2) ... 17

New York-New Jersey Port Authority Compact: Cong. Consent Pub.L. No. 96-163, 93 Stat. 1242 (1979) . 2

New York-New Jersey Port Authority Compact: Cong. Consent 42 Stat. 174 (1921) 2

Public Utility Regulatory Policies Act of 1978, Pub.L. No. 95-617, 92 Stat. 3117:

§ 210, 16 U.S.C. § 824a-3 (Supp. IV 1980) ..... *passim*

§ 210(a), 16 U.S.C. § 824a-3(a) (Supp. IV 1980) .. *passim*

Table of Authorities Continued

Page

§ 210(b), 16 U.S.C. § 824a-3(b) (Supp. IV 1980) 8, 9, 11, 12, 20, 21
§ 210(b)(1), 16 U.S.C. § 824a-3(b)(1) (Supp. IV 1980) 23
§ 210(b)(2), 16 U.S.C. § 824a-3(b)(2) (Supp. IV 1980) 23
§ 210(c), 16 U.S.C. § 824a-3(c) (Supp. IV 1980) 9
§ 210(d), 16 U.S.C. § 824a-3(d) (Supp. IV 1980) 9
§ 210(e), 16 U.S.C. § 824a-3(e) (Supp. IV 1980) 9
§ 210(e)(1), 16 U.S.C. § 824a-3(e)(1) (Supp. IV 1980) 7
§ 210(e)(2), 16 U.S.C. § 824a-3(e)(2) (Supp. IV 1980) 9
§ 210(e)(3), 16 U.S.C. § 824a-3(e)(3) (Supp. IV 1980) 9
§ 210(e)(3)(B), 16 U.S.C. § 824a-3(e)(3)(B) (Supp. IV 1980) 9, 14, 16, 17, 18, 19, 20
§ 210(f), 16 U.S.C. § 824a-3(f) (Supp. IV 1980) 8, 9, 14, 15, 16, 17, 18
§ 210(g), 16 U.S.C. § 824a-3(g) (Supp. IV 1980) 8, 9
§ 210(h), 16 U.S.C. § 824a-3(h) (Supp. IV 1980) 8, 9
§ 210(h)(1), 16 U.S.C. § 824a-3(h)(1) (Supp. IV 1980) 16
§ 603, 16 U.S.C. § 2645 (Supp. IV 1980) 26
N.J.S.A. 32:1-35.72 to 1-35.93 (West 1982) 2
N.Y. Public Service Law §§ 2, 66-c (McKinney 1981) . 26
N.Y. Unconsolidated Laws §§ 7171-7192 (McKinney 1979) 2

REGULATIONS:

18 C.F.R. § 292.101(b)(6) 12
18 C.F.R. § 292.101(b)(7) 16
18 C.F.R. § 292.302 27
18 C.F.R. § 292.303 11
18 C.F.R. § 292.303(c) 10, 11, 15
18 C.F.R. § 292.304(a) 12
18 C.F.R. § 292.304(b) 12
18 C.F.R. § 292.304(b)(3) 12

Table of Authorities Continued

Page

18 C.F.R. § 292.304(b)(4) 11, 12
18 C.F.R. § 292.304(e) 22
18 C.F.R. § 292.306 16
18 C.F.R. § 292.403(b) 29
Arizona: PSC Docket No. 81-045, Decision No. 52345 (July 27, 1981) 28
California: *In re* Southern California Edison Co.—Heber Geothermal Generation Station, Application No. 61167, Decision No. 82-10-049 (CPUC, Oct. 20, 1982) 21
Florida PSC Order No. 9970 (April 22, 1981) 29
Florida PSC Order No. 10,943 (June 28, 1982) 28
Florida PSC Docket No. 810296-EU 28
Florida Admin. Code § 25-17.82 27
Florida Admin. Code § 25-17.82(2)(b) 26
Florida Admin. Code § 25-17.82(3) 28
Idaho PUC Case No. P-300-12, Order Nos. 15746 (Aug. 8, 1980) and 16025 (Dec. 2, 1980) 28
Maine: 65-407 C.M.R. Ch. 36, § 3B1 27
Maine: 65-407 C.M.R. Ch. 36, § 3C 28
Massachusetts Admin. Code, Title 220, § 8.05 28
New Hampshire Public Utilities Comm., Order No. 14,280 in Docket No. DE 79-208 (June 18, 1980) reversed in part on other grounds, *Appeal of Granite State Electric Co.*, 435 A.2d 119 (N.H. 1981) 26
New Jersey Board of Public Utilities, Docket No. 8010-687 Decision and Order (Oct. 14, 1981) 27, 28
Oklahoma Corporation Commission Order No. 186937, Cause No. 27208 (March 26, 1981) 27, 28
Texas Public Utility Commission, Docket No. 3955, Order issued Oct. 15, 1981 27
Vermont Public Service Board, General Order No. 65 (June 18, 1981) 26

Table of Authorities Continued

Page

FEDERAL REGISTER:

45 Fed. Reg. 12,221 (1980) 11

45 Fed. Reg. 12,222-12,223 (1980) 12, 13, 25

HEARINGS:

Hearings on the National Energy Act (H.R. 6831) Before the Subcomm. on Energy and Power of the House Comm. on Interstate and Foreign Commerce, 95th Cong., 1st Sess., Pt. 3 (1977) 7

Public Utility Rate Proposals of President Carter's Energy Program (Part E of S.1469): Hearings Before the Subcomm. on Energy Conservation and Regulation of the Senate Comm. on Energy and Natural Resources, 95th Cong., 1st Sess., Pt. 1 (1977) 6

REPORTS:

H. Conf. Rept. 95-1750, 95th Cong., 2d Sess. (1978) .. 17, 24

MISCELLANEOUS:

Los Angeles Times, Nov. 17, 1982 21

National Regulatory Research Institute, *The Appropriateness and Feasibility of Various Methods of Calculating Avoided Costs* (1982) 26, 29

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Diamond Shamrock Corporation, Hoffmann-La Roche Inc., Madison Paper Industries, Parsons & Whittemore, Inc., The Port Authority of New York and New Jersey and Union Oil Company of California file this brief as *amici curiae* in support

of petitioners to urge that the decision of the court below be reversed.

INTERESTS OF *AMICI CURIAE*

Amici curiae are five private companies and one public agency which engage in various operations throughout the United States. Diamond Shamrock Corporation is an energy and chemical concern. Hoffmann-La Roche Inc. manufactures pharmaceuticals, fine chemicals, vitamins and diagnostics. Madison Paper Industries, a joint venture formed by The New York Times Company and Myllykoski Oy, a Finnish company, operates a paper mill. Parsons & Whittemore, Inc. operates manufacturing facilities in the pulp and paper industry and, more recently, has constructed and operates resource recovery facilities that generate electricity from municipal solid waste. Union Oil Company of California is a natural resource concern engaged in oil and gas operations, minerals recovery, petroleum refining, chemical production and geothermal and oil shale projects.

The public *amicus curiae* is the Port Authority of New York and New Jersey, a joint agency of the two States created in 1921 by an interstate compact with the consent of Congress.[1] In 1978, the two States adopted legislation authorizing the Port Authority to provide for the development of industrial parks and resource recovery facilities. N.J.S.A. 32: 1-35.72 to 35.93; N.Y. Unconsolidated Laws §§ 7171-7192 (McKinney 1979). In 1979, Congress consented to the bi-State legislation. Pub.L. No. 96-163, 93 Stat. 1242 (1979). The Port Authority is now

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[1] See 42 Stat. 174 (1921) consenting to Ch. 154, Laws of N.Y., 1921; and Ch. 154, Laws of N.J., 1921. Pursuant to the compact and supplementary bi-state legislation, the Port Authority has been directed to plan, develop and operate terminals and other facilities of transportation and commerce within the Port of New York District, an area approximately within a 25-mile radius of the Statue of Liberty.

developing such facilities, which will, *inter alia*, convert garbage into steam and electricity.

Despite their diversity, these *amici curiae* have one interest in common. Each generates or plans to generate electricity by nontraditional means. Under a process known as cogeneration, *amici curiae* can burn fuels both to generate electricity and to supply steam needed for much of their industrial production. In addition, *amici curiae* are using or seeking to use various non-fossil fuel sources to produce electricity for sale in a competitive marketplace. The following examples give some idea of the kind of projects *amici curiae* have:

• At a calciner plant in California, a new waste heat recovery system will raise steam to drive a 25,000-kilowatt generator with energy that would otherwise be wasted. Lengthy negotiations with a traditional electric utility conducted within the framework of existing Federal Energy Regulatory Commission rules have yielded a long-term agreement with price tied to the utility's avoided cost.

• The nation's largest resource recovery plant began to turn municipal waste into enough electricity to supply 40,000 homes in Southern Florida after the Florida Public Service Commission ordered the traditional utility in the area to interconnect with the nontraditional facility.[2] Payments are being made to reflect the traditional utility's actual fuel savings, hour-by-hour.

• A new 200,000-kilowatt cogeneration facility in Texas generates electricity in two gas turbines, recovers waste heat

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[2] The utility has appealed this decision to the Florida Supreme Court which has not yet decided the case. *Metropolitan Dade County and Florida Power & Light Co.* v. *The Florida Public Service Commission*, No. 61,536 (argued October 5, 1982). In support of its interconnection order in that case, the Public Service Commission relies both on authority to order interconnections under State law and on the federal rule here at issue.

with which it produces high-pressure steam that drives a steam turbine, and then uses reduced-pressure steam in a chlorine caustic plant. A traditional utility buys all of the power under a one-year, evergreen contract. It pays a tariff rate set at the utility's average fuel cost multiplied by factors designed to approximate avoided energy cost. The utility has asked the Public Utility Commission of Texas to reduce those rates on the grounds that its avoided costs are decreasing as cogeneration in its service area increases from 300,000 to 1,000,000 kilowatts.

• A pulp mill in Alabama burns wood wastes, with coal as back-up fuel, generates steam and electricity for internal needs and sells a modest surplus to the nearby utility under a fixed-price contract.

• Innovative technology at a New Jersey plant that produces fine chemicals will utilize a slow-speed marine diesel engine to generate 23,000 kilowatts, enough electricity to satisfy plant needs, while simultaneously supplying close to a third of plant process steam requirements. As a result, one of the existing steam boilers will be placed in a standby capacity. Negotiations with the traditional utility are under way.

• Low-head hydroelectric projects on the property of a recently-expanded paper mill in Maine generate about 9,000 out of a maximum of 40,000 kilowatts consumed at the mill. An investor-owned utility is interconnected via lines owned by an intervening municipal electric utility. Contractual payments are tied to generic purchase rates set from year to year by the Maine Public Utilities Commission.

• A cogeneration facility in Texas generates almost a third of a chemical plant's internal needs while supplying process steam as well.

• Pursuant to Memoranda of Understanding with Essex County and the City of Newark, New Jersey, and with the City of New York, the Port Authority would provide several $200 million resource recovery facilities to convert garbage into steam and electricity, if economically feasible. The electric

capacity of each facility would approximate 30,000 kilowatts. Feasibility turns on securing satisfactory arrangements with utilities for interconnection and sale of electricity.

• A refinery in California is planning to install capacity to generate about 10,000 kilowatts of electricity from waste heat. The proposal will go forward only if projected revenues from the sale of electricity justify the investment.

The present and planned electric generating operations of *amici curiae* thus represent a broad spectrum of electric generating facilities, technologies and arrangements. Some of these facilities produce all their electricity for delivery to a traditional electric facility. Others use all electricity generated within the industrial plant. Some buy emergency or back-up power from a traditional utility, whereas others purchase all their plant needs under a conventional industrial rate schedule and sell all of their output. Some are negotiating long-term contracts with traditional utilities, others deal on a short-term contract or spot sales basis.

Each nontraditional facility requires interconnection with one or more traditional electric utilities (which usually hold a monopoly over the local electric transmission grid), and each has a vital stake in the payment mechanism for purchases by traditional, franchised-monopoly electric utilities from qualifying facilities. *Amici curiae*, as operators of these qualifying facilities, thus have a common—and important—concern for the proper administration of Section 210 of the Public Utility Regulatory Policies Act of 1978 (hereinafter "PURPA Section 210"), a statute which, as the Court has observed, was enacted to "encourage the development of cogeneration and small power production facilities." *FERC* v. *Mississippi*, No. 80-1749 (June 1, 1982), slip op. 6, 102 S.Ct. 2126, 2132.

Spurred by the enactment of PURPA Section 210, *amici curiae* and other industrial concerns are searching for new ways to generate electricity or increase their existing capacity. Each *amicus curiae* has—either in place or under consideration—cogeneration or small power production proj-

ects the economic viability of which could stand or fall on the outcome of this case. As the sponsors of PURPA Section 210 recognized, these projects and others like them could ultimately enable industrial firms to produce a large percentage of the national demand for electricity.[3]

By invalidating the FERC rule which mandates interconnections required for electricity transfers between qualifying facilities and electric utilities and by casting doubt on the reasonable and economically realistic pricing mechanism adopted by the Commission under PURPA Section 210, the court below has threatened the statute's effectiveness. *Amici curiae* believe that the congressional objective of PURPA Section 210 should not be impeded by improper judicial interference with the ability of the Commission to carry out its statutory responsibilities or by an erroneous judicial construction that jeopardizes the ability of industrial generators to sell electricity to electric utilities, which commonly are the principal, if not the only, available purchasers. *Amici curiae* therefore support petitioners in this case and urge that the decision of the court of appeals be reversed.

STATEMENT

A. PURPA Section 210

PURPA Section 210 was enacted primarily to overcome two impediments to the development of nontraditional electric generating facilities. First, as the Court observed in *FERC* v. *Mississippi*, No. 80-1749 (June 1, 1982), 102 S.Ct. 2126, traditional electricity utilities were reluctant to purchase power from, and sell power to, the nontraditional facilities. Slip op. at

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[3] *Public Utility Rate Proposals of President Carter's Energy Program (Part E of S. 1469): Hearings Before the Subcomm. on Energy Conservation and Regulation of the Senate Comm. on Energy and Natural Resources*, 95th Cong., 1st Sess. Pt. 1 at 141-43 (1977) (Report from the Library of Congress, Congressional Research Service).

6, 102 S.Ct. at 2132. In the graphic words of one witness before the House subcommittee:

> The declining use of cogeneration by industry in this country can be traced directly to the antagonism of the electric utility companies. They have virtually strangled cogeneration . . . by charging discriminatory backup rates to customers who cogenerate, and by either refusing to buy excess electricity from cogenerators or offering an unfairly low rate.[4]

The second impediment was that "regulation of these alternative energy sources by state and federal utility authorities imposed financial burdens upon the nontraditional facilities and thus discouraged their development." *FERC* v. *Mississippi*, slip op. at 6-7, 102 S.Ct. at 2132-33.

PURPA Section 210 addresses both impediments. The historic antagonism of utilities is met by provisions that call for federal adoption of purchase and sale rules for implementation by State regulatory authorities. The problem of undue regulatory burdens is met by authorizing FERC to prescribe rules exempting qualifying facilities "in whole or in part from the Federal Power Act, from the Public Utility Holding Company Act, from State laws and regulations respecting the rates, or respecting the financial or organizational regulation, of electric utilities . . ." PURPA Section 210(e)(1), 16 U.S.C. § 824a-3(e)(1).

1. Provisions In PURPA Section 210 Regarding Purchase and Sale Rules

PURPA Section 210(a) directs FERC to prescribe " 'such rules as it determines necessary to encourage cogeneration and small power production,' including rules requiring utilities to offer to sell electricity to, and purchase electricity from,

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[4] *Hearings on the National Energy Act (H.R. 6831) Before the Subcomm. on Energy and Power of the House Comm. on Interstate and Foreign Commerce*, 95th Cong., 1st Sess., Pt. 3 at 356-57 (1977).

qualifying cogeneration and small power production facilities." *FERC* v. *Mississippi*, slip op. at 7, 102 S.Ct. at 2133, quoting PURPA Section 210. Under subsection (b), these rules "shall insure that, in requiring any electric utility to offer to purchase . . . from any qualifying . . . facility, the rates for such purchase—

> (1) shall be just and reasonable to the electric consumers of the electric utility and in the public interest, and
>
> (2) shall not discriminate against qualifying cogenerators or qualifying small power producers.[5]

The statute explicitly provides that implementation of the purchase and sale rules is largely a State, not a federal, responsibility. PURPA Section 210(f) requires each State regulatory authority to "implement [the rules prescribed by FERC under subsection (a)] for each electric utility for which it has ratemaking authority."[6]

In sum, Congress fashioned an innovative regulatory mechanism, under which State ratemaking authorities follow standards set forth in federal rules, to overcome one of the two major impediments to increased generation of electricity by

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[5] PURPA Section 210(b) sets an upper limit on the amount utilities might be required under FERC rules to pay for electricity produced by cogenerators and small power producers. It provides that no FERC rule "shall provide for a rate which exceeds the incremental cost to the electric utility of alternative electric energy." 16 U.S.C. § 824a-3(b).

[6] PURPA Section 210(f), 16 U.S.C. § 824a-3(f). The constitutionality of this provision was upheld by the Court in *FERC* v. *Mississippi*, slip op. at 15-17, 102 S.Ct. at 2137-2138; see also, opinion of Justice O'Connor, concurring in part and dissenting in part, at 1, n.1, 102 S.Ct. at 2146, n. 1

Federal implementation of PURPA Section 210(a) is dealt with in subsections 210(g) and 210(h), which provide, *inter alia*, that FERC rules under Section 210(a) "shall be treated as . . . rule[s] under the Federal Power Act" for those who are subject to the Commission's jurisdiction under the Federal Power Act.

cogenerators and small power producers. The statutory provisions which establish this mechanism—PURPA Sections 210(a)-210(d) and 210(f)-210(h)—create both the authority and the obligations necessary to make it work. Under PURPA Section 210, FERC has both the authority and the obligation to prescribe purchase and sale rules, and State regulatory agencies have both the authority and the obligation to implement these rules.

2. Provisions In PURPA Section 210 Regarding Exemptions From Unnecessary Regulation

PURPA Section 210(e) is designed to remove the second impediment to increased cogeneration and small power production—the problem of unnecessary and unduly burdensome regulation. *FERC* v. *Mississippi*, slip op. at 7, 102 S.Ct. at 2133. Unlike the problem of utilities' historic refusal to deal, this problem can be solved without compelling any producer or user of electricity to act differently than it might otherwise act. Accordingly, PURPA Section 210(e) contains no provisions that compel action by these persons. Its function is to authorize FERC to grant freedom from existing regulatory obligations, not to impose new obligations.

Sections 210(e)(2) and 210(e)(3) set forth certain limitations on this authority. One of these limitations is that—

> (3) [n]o qualifying . . . facility may be exempted under this subsection [Section 210(e)] from—
>
> (B) the provisions of section 210, 211 or 212 of the Federal Power Act [16 U.S.C. 824i, 824j, or 824k] or the necessary authorities for enforcement of any such provision under the Federal Power Act [16 U.S.C. 791a et seq.]

Understanding the foregoing limitation on FERC's power to grant exemptions requires analysis of the three sections of the Federal Power Act to which PURPA Section 210(e)(3)(B) refers. Section 210 of the Federal Power Act, 16 U.S.C. § 824i (hereinafter "FPA Section 210"), grants FERC authority, upon application of any "electric utility . . . qualifying cogenerator or qualifying small power producer," to order,

inter alia, "the physical connection of any cogeneration facility, any small power production facility, or the transmission facilities of any electric utility, with the facilities of such applicant." Section 211 of the Act, 16 U.S.C. § 824j (hereinafter "FPA Section 211"), grants the Commission authority, upon application of "[a]ny electric utility or Federal power marketing agency," to order any other electric utility to provide transmission services to the applicant. Both sections set forth findings that the Commission must make before issuing an order, and both sections provide that, before an order is issued, further findings set forth in Section 212 of the Federal Power Act, 16 U.S.C. § 824k (hereinafter "FPA Section 212"), must be made.

The language of FPA Sections 210, 211 and 212 imposes no obligation upon cogenerators or small power producers, unless and until the Commission issues an order. The words of these sections—which, as enacted, bore the headings "Certain Interconnection Authority" and "Certain Wheeling Authority," (92 Stat. 3135-3136)—do not make these sections exclusive and do not compel cogenerators or small power producers to apply for the orders FERC is authorized to issue. In fact, the only obligations that could arise under the words of these sections of the Federal Power Act would arise by virtue of a valid order issued by FERC. Accordingly, the only obligation that an exemption from the provisions of FPA Sections 210, 211 or 212 would remove would be the obligation to obey specific Commission orders entered pursuant to those sections.

B. Pertinent Rules Promulgated By The Commission Pursuant To The Provisions In PURPA Section 210

Two provisions of the rules prescribed by FERC under PURPA Section 210 were declared unlawful by the court of appeals in this case. The first requires utilities to "make such interconnections [with qualifying facilities] as may be necessary to accomplish purchases and sales" (18 C.F.R. § 292.303(c)); the second requires that rates for utility purchases of electricity from "new capacity" must equal the utility's

"avoided costs determined [by the appropriate State ratemaking authority] after consideration of" certain factors set forth in the rules (18 C.F.R. § 292.304(b)(4)).

1. The Interconnection Rule

FERC's rule regarding interconnection of electric utilities with qualifying facilities appears in 18 C.F.R. § 292.303—a section in the rules entitled "Electric Utility Obligations under this Subpart." The first two obligations set forth in this section merely reflect the statutory direction to prescribe rules requiring electric utilities to offer to purchase electricity from and sell electricity to qualifying facilities. The third obligation, set forth in 18 C.F.R. § 292.303(c), is described in the Commission's preamble to the final rules as follows:

> Paragraph (c)(1) thus provides that an electric utility must make any interconnections with a qualifying facility which may be necessary to permit purchases from or sales to the qualifying facility. A State regulatory authority or nonregulated electric utility must enforce this requirement as part of its implementation of the Commission's rules. 45 Fed. Reg. 12,221.

The interconnection rule at issue in this case therefore requires utilities to do nothing more than what is necessary to comply with the purchase and sale requirements that PURPA Section 210(a) expressly mandates the Commission to prescribe. Moreover, even if the FERC rules had been silent on the matter of interconnection, State regulatory authorities would be bound by PURPA Section 210(f) to recognize—and enforce—a duty to interconnect as part of their statutorily-mandated implementation of the Commission's purchase and sale rules.

2. The Avoided Cost Rule

PURPA Section 210(b) directs that FERC's rules insure that rates of purchase and sale "shall be just and reasonable to the electric consumers of the electric utility and in the public

interest" and "shall not discriminate against qualifying [facilities]" (PURPA Section 210(b)). Pursuant to this statutory direction, FERC adopted a rule which imposes these standards upon State regulatory authorities *in haec verba*. See 18 C.F.R. § 292.304(a).

In addition, the FERC rules provide that, in many instances, these statutory standards can be satisfied only by purchase rates that are equal to the utilities' "avoided costs"—that is, equal to the incremental costs for electricity which, but for the purchase, the utility would generate for itself or purchase from another source. 18 C.F.R. § 292.304(b); see also 18 C.F.R. § 292.101(b)(6). The FERC rules distinguish "new" capacity from capacity for which construction was commenced prior to November 9, 1978. On purchases from "new" capacity, rates for purchases are deemed to meet the statutory standards only if they equal the purchasing utility's avoided costs, as determined by the State ratemaking authority. 18 C.F.R. § 292.304(b)(4).[7]

The Commission set forth its reasons for avoided cost purchase rates in its preamble to the final rules. See 45 Fed. Reg. 12,222-12,223. After summarizing the various positions asserted in comments on previously proposed rules, FERC noted the obvious. "[I]n most instances, if part of the savings from cogeneration and small power production were allocated among the utilities' ratepayers, any rate reductions will be insignificant for any individual customer." 45 Fed. Reg. 12,222. Conversely, as the Commission also observed—

> if these savings are allocated to the relatively small class of qualifying cogenerators and small power producers, they

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[7] For other purchases (i.e., from capacity for which construction began prior to November 9, 1978), the rates may be less than avoided costs if the State regulatory authority determines that a lower rate is consistent with the statutory standards and "is sufficient to encourage cogeneration and small power production." 18 C.F.R. § 292.304(b)(3).

> may provide a significant incentive for a higher growth rate of these technologies. *Id.*

Two methods of rate determination proposed in the comments were discussed and rejected by FERC. The first would have employed a so-called "split-the-savings" device, under which a utility and a qualifying facility would split the difference between the qualifying facility's incremental cost and the incremental cost the utility would have incurred had it generated the power itself or purchased it elsewhere. This method was rejected for several reasons, the most telling of which was that "it would require a determination of the costs of production of the qualifying facility"—a regulatory burden of the precise kind that PURPA Section 210 intends to remove. A second method of rate determination would have set purchase rates at a fixed percentage of the avoided costs. FERC rejected this method on the following reasoning:

> The Commission notes that, in most situations, a qualifying cogenerator or small power producer will only produce energy if its marginal cost of production is less than the price he receives for its output. If some fixed percentage is used, a qualifying facility may cease to produce additional units of energy when its costs exceed the price to be paid by the utility. If this occurs, the utility will be forced to operate generating units which either are less efficient than those which would have been used by the qualifying facility, or which consume fossil fuel rather than the alternative fuel which would have been consumed by the qualifying facility had the price been set at full avoided costs. 45 Fed. Reg. 12,222-12,223.

The avoided cost rules thus were adopted after full consideration and discussion of alternatives proposed. In the course of this discussion, FERC explained why it rejected the alternatives in favor of the avoided cost rule—a rule that embodies the simple concept of requiring the utility to pay a qualifying facility the cost the utility would incur to obtain the same electricity by internal generation or purchase from another supplier.

SUMMARY OF ARGUMENT

Under PURPA Section 210(f), State regulatory authorities are required to implement the purchase and sale rules prescribed by FERC under PURPA Section 210(a). By virtue of PURPA Section 210(f), State regulatory authorities therefore have the legal power to order utilities under their jurisdiction to make interconnections necessary for purchases and sales required by the FERC rules—even if these rules should not explicitly require such interconnections. By invalidating the FERC interconnection rule, the court below encumbers FERC's power to order interconnection with procedures and conditions that do not restrict the interconnection authority which PURPA Section 210(f) gives the States. State interconnection authority, moreover, cannot be restricted by PURPA Section 210(e)(3)(B)—the statutory provision upon which the court relied in curbing FERC's powers. This anamolous result, under which FERC is bound by restrictions that cannot be held to bind the State regulatory authorities, is consistent with neither the words of PURPA Section 210, nor with the purposes of the statute.

The holding of the court of appeals invalidating FERC's avoided cost rate rule is premised upon the court's erroneous view that PURPA Section 210 imposes a "balancing test," under which FERC is required to reach a compromise of three interests—the interest of electric consumers, the interest of cogenerators and small power producers and "the public interest." PURPA Section 210 contains no such "balancing test." Congress itself struck the balance and directed FERC to prescribe rules to insure that rates at which qualifying facilities purchase electricity meet each of three standards set forth in the statute. These rates must be "just and reasonable to electric consumers" and "in the public interest" and shall not "discriminate against qualifying cogenerators or small power producers." As FERC explains with precision and clarity in the preamble to its rules, the rule requiring avoided cost rates for purchases of electricity from new capacity does not discriminate against qualifying facilities and is demonstrably just

and reasonable to the electric consumer and in the public interest. The administrative record does not fail, as the court of appeals erroneously held, to explain the Commission's reasoning in reaching this virtually self-evident conclusion.

ARGUMENT

I.

THE COMMISSION'S RULE REQUIRING ELECTRIC UTILITIES TO MAKE INTERCONNECTIONS NECESSARY TO ACCOMPLISH PURCHASE AND SALE TRANSACTIONS WITH QUALIFYING FACILITIES IS NOT CONTRARY TO THE PROVISIONS IN PURPA SECTION 210

The interconnection rule, which the court of appeals held unlawful under PURPA Section 210, does little more than declare explicitly an obligation that PURPA Section 210 itself, by necessary implication, imposes upon electric utilities. PURPA Section 210(a) expressly directs FERC to prescribe rules that require electric utilities to offer to purchase electricity from and sell electricity to qualifying cogeneration and small power production facilities. PURPA Section 210(f) directs that, within one year after they are prescribed, each State regulatory authority must implement these rules. Since sales and purchases of electricity cannot take place without interconnection of electric facilities, the implementation provisions in PURPA Section 210(f), as well as the provisions of PURPA Section 210(a), must contemplate that utilities will be obliged to "make such interconnections . . . as may be necessary to accomplish purchase and sales"—precisely the obligation imposed by the FERC interconnection rule. 18 C.F.R. § 292.303(c).

The court of appeals, however, invalidated the rule, thus rejecting "the contemporaneous construction of a statute by the [Commission] charged with the responsibility of setting its machinery in motion." *Udall* v. *Tallman*, 380 U.S. 1, 16 (1965). This holding ignores the established canon of statutory con-

struction under which the courts give "great deference to the interpretation given the statute by the officers or agency charged with its administration." *Id.*; see also *Train* v. *Natural Resources Defense Council*, 421 U.S. 60, 75 (1975); *Red Lion Broadcasting Co.* v. *FCC*, 395 U.S. 367, 381 (1969).

PURPA Section 210 cannot properly be read to invalidate the FERC interconnection rule. PURPA Section 210(f) provides that implementation of FERC rules requiring utilities to purchase and sell electricity is a State responsibility. Consequently, the interconnections necessary for these purchases and sales to take place are primarily the responsibility not of FERC, but of State regulatory authorities.[8] By virtue of PURPA Section 210(f), these State agencies have not only the authority but also the obligation to implement rules requiring purchases and sales adopted by FERC under PURPA Section 210(a).

The opinion below nowhere mentions this State obligation, but the statutory provision upon which the court principally relies in holding that FERC has no authority to adopt an interconnection rule—PURPA Section 210(e)(3)(B)—provides no basis for restricting the authority granted to State regulato-

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[8] The FERC interconnection rule provides guidance for State regulatory authorities concerning their critical role in implementing the purchase and sale rules mandated by PURPA Section 210(a) and lays down principles for resolving the question of who must bear the costs resulting from operation between interconnected electric utilities and qualifying facilities. See 18 C.F.R. §§ 292.101(b)(7) and 292.306. In addition, under PURPA Section 210(h)(1), the Commission's interconnection rule, like all rules prescribed under PURPA Section 210(a), must be treated as "a rule under the Federal Power Act." The interconnection rule consequently provides an important federal enforcement alternative to support the State enforcement powers.

ry agencies under PURPA Section 210(f). These State implementation powers must include the power to direct utilities to make interconnections that are necessary for purchase and sale transactions with qualifying cogenerators and small power producers. Should State regulatory authorities not have this power, they would be legally unable to carry out the statutory command in PURPA Section 210(f) that they implement the purchase and sale requirements of PURPA Section 210(a).

The court below appears to have viewed the question presented by the Commission's interconnection rule as whether PURPA Section 210(e)(3)(B) expresses a Congressional intention that interconnection between electric utilities and qualifying facilities may be ordered by FERC only under the provisions of Sections 210 and 212 of the Federal Power Act.[9] By

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[9] FERC has, as well, other authority under the Federal Power Act to order interconnections, authority that both preceded PURPA and continues to exist. FPA Section 202(b), 16 USC § 824a(b), provides that, under certain circumstances, FERC may "direct a public utility . . . to establish physical connection of its transmission facilities with the facilities of one or more other persons engaged in the transmission or sale of electric energy." This section was added in 1935 to the Federal Power Act, 49 Stat. 848 § 213, and was not affected by the addition of new Power Act sections 210, 211 and 212 in 1978. *See* FPA § 212(e)(2) and H. Conf. Rept. 95-1750, p. 94. These latter sections have only the limited purposes of filling jurisdictional omissions in FERC's authority to order interconnection to the interstate grid and sale or exchange of electric energy by intrastate and other non-jurisdictional utilities (particularly in Texas) and to order certain transmission services. It also satisfies the Commission's long-standing desire for authority to act on its own motion.

FPA Sections 210 and 212 (and in most cases, 211) confer on cogenerators and small power producers as such and as "electric utilities" (broadly defined, with few exceptions, as sellers of electric energy), supplementary, but by no means exclusive, rights under the Federal Power Act. *See* FPA section 212(e)(1). Qualifying facilities are nowhere restricted in these sections regarding access to Section

holding that Section 210(e)(3)(B) of PURPA should be so read, the decision below creates the anomalous situation that State regulatory authorities can—and must, if they are to comply with PURPA Section 210(f)—order interconnection whenever necessary to implement the purchase or sale requirement of Section 210(a), while FERC's powers with respect to interconnection are restricted by the procedures and findings set forth in Sections 210 and 212 of the Federal Power Act.

This result was not intended by PURPA Section 210(e)(3)(B). The words of that subsection merely limit the Commission's power to exempt qualifying facilities from federal and State regulation as follows:

> No qualifying small power production facility or qualifying cogeneration facility may be exempted under this subsection from
>
> * * *
>
> (B) the provisions of section 210, 211, or 212 of the Federal Power Act [16 U.S.C. 824i, 824j, or 824k] or the necessary authorities for enforcement of any such provision under the Federal Power Act [16 U.S.C. 791a et seq.]

These words, read in accordance with their normal usage, mean simply that the Commission may not free qualifying facilities from obligations imposed by FPA Sections 210, 211 and 212. Moreover, the context in which these words appear—as part of a provision designed to free qualifying cogenerators and small power producers from the burdens of compliance

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202(b) of the Federal Power Act or independent state laws, much less the broad new purchase and sale rights conferred by PURPA Section 210(a). When P.L. 95-617 simultaneously enacted PURPA Section 210 and FPA Sections 210 and 212, Congress intended to create a full panoply of possibly duplicative rights, risking no omissions. It did not intend that any of these rights must be used to the exclusion of any other.

with unnecessary regulatory obligations—confirms that this meaning accords with the intent of Congress.

If an order under FPA Section 210, 211 and 212 should be entered, the provisions of these sections would apply to a qualifying facility—and nothing in the FERC rules under PURPA Section 210 provides otherwise. Absent such an order, however, the provisions of FPA Sections 210, 211 and 212 impose no obligation whatsoever upon cogenerators or small power producers. The Commission's interconnection rule—which imposes an obligation upon electric utilities to interconnect with qualifying facilities in order to effect the purchases or sales contemplated by PURPA Section 210(a)—does not operate to free qualifying facilities from any obligation that might be imposed upon them by an order entered under FPA Sections 210, 211 or 212. Accordingly, the Commission's interconnection rule does not violate PURPA Section 210(e)(3)(B) by "exempting" qualifying facilities from provisions of the Federal Power Act, and the contrary holding of the court of appeals does not follow the wording of PURPA Section 210.

The purposes of PURPA Section 210, moreover, do not support the construction adopted by the court of appeals. As the Court recognized in *FERC* v. *Mississippi*, *supra*, it was the historic antagonism of the traditional electric power industry toward cogeneration and small power production that prompted Congress to enact the statute. A holding that resort to the cumbersome procedures in FPA Sections 210 and 212 is required for FERC to compel recalcitrant utilities to make interconnections would give these utilities yet another procedural device to delay, and perhaps avoid altogether, their obligations to deal with cogenerators and small power producers.

The Federal Energy Regulatory Commission, with close to a half century of experience in regulating electric utilities, is the agency charged by Congress with federal administration of PURPA Section 210. This agency determined that a federal

interconnection rule was necessary to advance the objectives of that section in the face of electric utility opposition. This determination is consistent with the statutory language and fully in accord with its purpose. The determination therefore is well within the agency's lawful authority, and it should not be overturned by the strained construction of Section 210(e)(3)(B) espoused by the court below.

II.

THE COMMISSION'S RULE REQUIRING THAT A UTILITY'S RATE FOR PURCHASES OF ELECTRICITY FROM NEW CAPACITY MUST EQUAL THE UTILITY'S AVOIDED COST IS FULLY JUSTIFIED AS A RULE WHICH INSURES THAT PURCHASE RATES SHALL NOT DISCRIMINATE AGAINST QUALIFYING FACILITIES AND SHALL BE JUST AND REASONABLE TO ELECTRIC CONSUMERS AND IN THE PUBLIC INTEREST

The avoided cost rule, which the court of appeals held "FERC did not justify and explain," *American Electric Power Service Corp.* v. *FERC*, 675 F.2d 1226, 1245 *reh'g denied*, 675 F.2d 1246 (D.C. Cir. 1982), precisely carries out the Congressional mandate expressed in PURPA Section 210. In that section, Congress required promulgation of such rules as the FERC "determines necessary to encourage cogeneration and small power production." PURPA Section 210(a). Contemplating that such rules must deal with rates for purchases by traditional electric utilities, but not intending unlimited encouragement of nontraditional facilities, Congress directed that "no such rule . . . shall provide for a rate which exceeds the incremental cost to the electric utility of alternative electric energy." PURPA Section 210(b).[10] Congress also pre-

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[10] The court of appeals erroneously conceived the incremental cost ceiling expressed in PURPA Section 210(b) as being an absolute upper limit of meaningful encouragement. Rates above incremental (or avoided) cost, however, would go further to encourage nontraditional generation and reduce dependence on foreign oil. In fact, a

scribed the following standards for federal and State rate-setting authorities:

> The rules prescribed under subsection (a) of this section shall insure that, in requiring any electric utility to offer to purchase electric energy from any qualifying cogeneration facility or qualifying small power production facility, the rates for such purchase—
>
> (1) shall be just and reasonable to the electric consumers of the electric utility and in the public interest, and
>
> (2) shall not discriminate against qualifying cogenerators or qualifying small power producers.

The opinion below errroneously drew from these statutory standards a "clear intent of section 210(b)" of PURPA "to strike a balance" among the interests of cogenerators, electric consumers of utilities and the public interest (675 F.2d at 1234). The court's three-way balancing test is pure invention. Congress did not establish a scheme under which administrative officers would be called upon to devise a series of compromises that would somehow weigh the relative importance of different interests. Congress itself struck the balance, which it expressed in the overall rulemaking mandate of PURPA

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utility's reaction to a recent California Public Utilities Commission decision indicates that, in some circumstances, an avoided cost rate does not provide sufficient incentive to encourage cogeneration. The California Commission had approved a proposal by a traditional utility to build a 47-megawatt geothermal generating plant, but denied the utility's proposal to include costs in the utility's rate base. Instead, the Commission limited the utility to the recovery of its own avoided costs, allowing the shareholders to retain the profit if the power costs less but requiring them to absorb the loss in case of excess costs. In re Southern California Edison Co., CPUC Decision No. 82-10-049, Oct. 20, 1982. The California Commission, therefore, would have precisely matched the economic incentive offered qualifying facilities by the avoided cost rule. The traditional utility announced that it would not proceed on that at-risk basis. Los Angeles Times, Nov. 17, 1982/Pt. II, p. 7.

Section 210(a) and in the three standards it directed the agency to follow for purchase rate rules.[11]

Since FERC wisely decided that both detailed rate formulas and specific numerical rates should be set by State regulatory commissions, its purchase rate rule transferred to State authorities the mandate to encourage cogeneration and small power production, the ceiling on rates and the three statutory standards. These aspects of the FERC purchase rate rule are not controverted. Respondent utilities confine their attack to a provision that, in cases of new capacity, the rate for purchases satisfies the rule only if it "equals the avoided costs determined after consideration of [certain] factors" enumerated in the rule.[12]

This provision is necessary to counteract the reluctance of traditional utilities, enjoying legal and functional monopoly and monopsony powers, to deal fairly with qualifying facilities. Lacking a competitive market, the Commission's avoided cost rule goes directly to the heart of the problem by approximating

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[11] Perhaps the clearest demonstration of the court of appeals' departure from the express Congressional direction to encourage cogeneration and small power production is the following portion of the opinion in which the court below actually urges the FERC to discourage cogeneration and small power production so long as the discouragement is not "disproportionate":

> FERC should allocate the benefits more evenly between the cogenerators and the utilities if the utilities can demonstrate that, under a percentage of avoided cost approach, an allocation less heavily favoring the cogenerators is in the public interest and the interest of the utilities' electric consumers, and will not disproportionately discourage cogeneration. (675 F.2d at 1234).

[12] These factors concern utility costs and projections, "availability of capacity or energy" provided by the qualifying facility during daily and seasonal peak periods, "relationship of the availability of energy or capacity" provided by the qualifying facility to the utility's ability to avoid costs, defer capacity additions and reduce fossil fuel use, and savings related to line losses. 18 C.F.R. § 292.304(e).

the price that would prevail in a competitive market place. If a free market existed in each electric utility service area, cogenerators and small power producers would be able to secure the direct costs avoided by the utility that purchases electricity from them (at least to the extent these areas represent relevant economic markets). Under such conditions, nontraditional, at-risk producers of electric power would receive market-clearing prices, and these prices would approximate incremental costs of electricity in the area—which is precisely what the FERC rules have entitled new, at-risk capacity to receive.

The avoided cost rule meets the standards enacted in PURPA Section 210. Subsection 210(b)(1) refers to "the public interest." The opinion below would have the Commission set this interest against the "cogenerator interest" and the "electric consumer interest" and reach some kind of "compromise" without clear principle by which to appraise the result. Admittedly, the Commission did not follow this far-ranging and highly unstructured procedure. Instead it satisfied PURPA's demand that "the rates for such purchase . . . shall be . . . in the public interest . . ." by establishing a market-clearing, avoided cost principle to encourage generation of electricity by qualifying facilities without subsidization by electric utilities.

PURPA Section 210(b)(2) also provides that rates "shall not discriminate against qualifying cogenerators or qualifying small power producers." This standard means rate setting authorities may not discriminate against qualifying facilities. For example, purchase terms extended to other traditional utilities may not be withheld or changed in a discriminatory way to the detriment of qualifying facilities. The avoided cost rule meets this standard.

The third standard demands that "rates for such purchase . . . shall be just and reasonable to the electric consumers of the electric utility . . . ." The opinion below found in this standard the clearest sign of a balancing requirement—because "just and reasonable" in utility ratemaking has been held to call for a balancing as between utility stockholder and ratepayer in-

terests. *Cf. FPC* v. *Hope Natural Gas Co.*, 320 U.S. 591 (1944).

Principles derived from utility rate cases, however, cannot be used to interpret the pricing mechanism Congress ordained for cogenerators and small power producers. In setting rates for a public utility, the interest of the utility's consumers must be weighed against the conflicting interest of the utility's stockholders, and rates are "just and reasonable" if a balance is struck that allows the stockholders a fair rate of return on their investment. Under PURPA Section 210, qualifying facilities "are not guaranteed a rate of return on their activities . . . vis a vis the sale of power to the utility and [their] risk in proceeding forward in the cogeneration or small power production enterprise is not guaranteed to be recoverable." H. Conf. Rept. 95-1750 at 97. If avoided cost rates drive a qualifying facility out of business, that is a business risk, like all other risks an unregulated firm must take. Whatever compromise the phrase "just and reasonable" may imply in other contexts, PURPA Section 210 requires rates that are "just and reasonable to electric consumers," not just and reasonable as between consumers and others.

The Commission's avoided cost rule meets the statutory standard. Under an avoided cost rate, utilities pay not a penny more than the costs they would have incurred if no cogenerator or small power producer had entered the market (and therefore have no excuse to attempt to charge ratepayers a penny more). The Commission's rule does not require a utility to forego any economy it can achieve. The rule thus fully protects the consumer. Moreover, increased competition in electric power production encouraged by the avoided cost rule will benefit electric consumers by lowering the cost and presumably the price of electricity.

The opinion below discusses certain circumstances under which the court of appeals believed that the avoided cost rule would injure consumers. In particular, the opinion states "if a utility has excess capacity the additional cogeneration encouraged by full avoided cost payments will result in higher rates

for all remaining customers of the utility" and asserts that these "higher rates for . . . remaining customers" would come about "because that [additional] cogeneration will reduce the number of customer-purchased kilowatt-hours over which the utility can spread a share of the fixed costs of that extra capacity." 675 F.2d at 1235.

This reasoning does not withstand analysis. Electric energy which a cogenerator has been encouraged to produce by full avoided cost payments, by definition, will be sold to the utility for resale in lieu of electricity the utility would have generated itself or purchased elsewhere. The utility therefore will sell to its customers precisely the same amount of electric energy that it would have sold if there were no cogeneration. The utility thus will have the same number of customer-purchased kilowatt-hours over which to spread its fixed costs. The only effect of the Commission's rule is that the cogenerator will receive payments equal to the costs that the utility otherwise would pay to other suppliers or incur itself in generating needed electric energy. If, on the other hand, the court had in mind a situation in which a cogenerator elects to use the electricity it generates rather than sell it to the utility—a likely supposition because of the opinion's use of the term "remaining customers"—then the cogenerator has not been encouraged to generate by avoided cost payments, but as a consequence of high retail electric rates. The higher rates that "remaining customers" might have to pay in this situation stem directly from the cogenerator's reducing its demands on utility capacity by self-generation—an exercise of the fundamental freedom to buy less in response to market forces—not the result of the Commission's avoided cost rule.

The opinion below invites FERC to substitute a percentage range in place of its full avoided cost rule by assigning responsibility to the State commissions "to set rates within a range—*e.g.*, 80-100 percent—authorized by the Commission." 675 F.2d at 1234. FERC considered and rightly rejected this suggestion. 45 Fed. Reg. 12,222-12,223. This scheme would

force State regulatory authorities to waste precious resources attempting to make the, at best, speculative determination of which percentage within the prescribed range is "enough." Under the rule adopted by FERC, the State commissions have set themselves much more meaningful agendae as they pioneer the critical work of encouraging cogeneration and small power production.[13] For example—

- State commissions are defining cost avoidance factors (such as time of day and emergency demands) that will send price signals that encourage the most beneficial production.[14]
- State commissions are weighing the needs for price stability and predictability against a desire for accuracy and auditability.[15]

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[13] *See*, generally, The National Regulatory Research Institute, *The Appropriateness and Feasibility of Various Methods of Calculating Avoided Costs* (1982) (hereinafter "NRRI"). The NRRI is the institute, referred to in PURPA Section 603, 16 U.S.C. 2645, established by the National Association of Regulatory Utility Commissioners.

[14] For example, prescribed rates are higher for on-peak hours than for off-peak hours in States such as Connecticut and North Carolina. NRRI, *op. cit.* note 13, *supra*, pp. 9, 16. A Florida-prescribed rate formula tracks avoided fuel cost "on an actual hour-by-hour basis." Fla. Admin. Code § 25-17.82(2)(b).

[15] Several states have determined that avoided costs rates should be set at specific amounts that remain in effect until modified by the State commissions. *E.g.*, Vermont (up to 9.0 cents per kilowatt hour in peak periods, 6.6 cents in off-peak periods), Vermont Public Service Board, General Order No. 65 (June 18, 1981); New Hampshire (up to 8.2 cents per kilowatt hour), New Hampshire Public Utility Commission Order No. 14,280 in Docket No. DE 79-208 (June 18, 1980), reversed in part on other grounds, *Appeal of Granite State Electric Co.*, 435 A.2d 119 (N.H. 1981). A New York statute sets a permanent floor of 6 cents per kilowatt-hour under cogeneration and small power production rates for facilities developed on or after June 26, 1980. N.Y. Public Service Law §§ 2, 66-c (McKinney 1981). Maine sets

- State commissions are assessing the various nontraditional generation technologies relevant to their areas and selecting between class rates and across-the-board rates.[16]
- State commissions are closely investigating costs utilities can avoid, related to their fuel mix, power pooling, conservation programs and other economizing opportunities.[17]

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rates for a specified period based on projections of avoided costs. 65-407 C.M.R. Ch. 36, § 3B1. On the other hand, some states have opted for after-the-fact determinations of certain avoided costs actually experienced by a power pool, New Jersey Board of Public Utilities, Decision and Order issued October 14, 1981, in Docket No. 8010-687, or by each individual utility, Fla. Admin. Code § 25-17.82. The Texas Public Utility Commission has approved avoided energy costs calculated by reference to average fuel cost (an auditable figure, calculated routinely for retail rate purposes) multiplied by uniform factors to arrive at an easily audited estimate of avoided fuel cost. Order issued October 15, 1981 in Dkt. No. 3955.

[16] Many states have adopted rates which distinguish qualifying facilities by size (i.e., rates are generally more predictable for qualifying facilities below 100 kilowatts capacity) rather than by type of generation used. However, Oklahoma has required utilities to calculate capacity credits separately for wind generators, for hydroelectric power and for photovoltaic generation. Oklahoma Corporation Commission, Order No. 186937 in Cause No. 27208 (March 26, 1981).

[17] The analysis of avoided costs for purposes of PURPA Section 210 focuses attention on utility plans, projections and cost levels, as reflected in 18 C.F.R. § 292.302. The New Jersey Board of Public Utilities uses a formula rate based on billing determinants of a multi-state power pool, plus 10%, to determine energy payment. It adds an avoided capacity cost payment which may also be based on a power pool figure. (Alternatively, the avoided capacity cost may be tied to a long-run incremental cost analysis for the purchasing utility, adjusted to an optimal fuel mix so as not to penalize qualifying facilities for excessive dependence on oil-fired capacity in the State.) N.J. Board of Public Utilities, Decision and Order issued October 14, 1981, in Docket No. 8010-687. Whereas Idaho was long able to rely

- State commissions are grappling with the value of capacity furnished by cogenerators to the utility grid.[18]

Not a single State agency has availed itself of the procedure the Commission's rules provide for seeking waiver of the full

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almost completely on low-price hydroelectric power, the Idaho Public Utility Commission now finds new, coal-burning plants to be significant for analyzing avoided capacity costs. Idaho PUC, Order Nos. 15746 and 16025 in Case No. P-300-12 (issued August 8 and December 2, 1980).

[18] Determination of the cost of capacity avoided by reason of purchases from nontraditional facilities poses among the most complex issues within the sphere of PURPA concerns. The Oklahoma Corporation Commission, holding that lack of certainty does not justify outright denial of any capacity payments, has prescribed experimental formulae on the following reasoning:

> The fact that the Commission lacks hard data demonstrating quantifiable avoided capacity costs does not, however, dictate that the Commission make no allowance for assumed avoided costs in setting a purchase rate.

See op. cit, note 16, *supra*, at p. 4.

Maine bases capacity credits on analyis of each utility's 15-year generation expansion plan. 65-407 C.M.R. Ch. 36, § 3C. New Jersey uses the cost of peaking capacity and Idaho uses costs of baseload coal capacity. *See op. cit.* note 17, *supra*. For small facilities "capable of delivering firm power" Arizona requires a reasonable capacity credit of "not less than 10% of the standard rate" for energy, and possibly more. Arizona PSC Decision No. 52345 issued July 27, 1981, in Docket No. 81-045. Several states distinguish "firm" from "as available" capacity. *E.g.*, Mass. Admin. Code, Title 220, § 8.05. The Florida Public Service Commission has tied the right of qualifying facilities to be paid a capacity credit to achieving seventy percent equivalent availability, Fla. Admin. Code § 25-17.82(3), believed to be the average availability achieved by generating units of traditional utilities. Fla. PSC Docket No. 810296-EU. The Florida Public Service Commission also has a staff proposal for forthcoming rulemaking to base capacity credits for cogenerators on a cost-effectiveness analysis of payments traditional utilities make to encourage conservation by retail customers. Fla. PSC Order No. 10,943, June 28, 1982.

avoided cost rule,[19] and the challenge to this rule in the court below has come from the traditional electric utility industry, not from the State regulatory authorities. State Commissions are doing vital, practical work, following priorities they find important in regions and service areas for which each has responsibility, and demonstrating "the wide-spread interest and originality of State commissions in adapting the concept of avoided cost" realistically.[20] Perhaps never before has the electric utility industry faced such rigorous scrutiny or such a surge of new competition or such a challenge to economize.

The FERC rule was promulgated in direct response to a congressional mandate to develop just such rules, after consultation with State commissions, for implementation by State commissions. The rule is entitled to much "more than mere deference or weight."[21] Even were FERC's careful and skillful decision in this complicated field reviewable *de novo*, however, the rule should be upheld. The rule makes sense. Indeed, it is hard to conceive of a different rule that would better enable State commissions to get on with the real job at hand—encouraging the literally thousands of existing and potential cogenerators and small power producers to enter the market and help meet energy needs.

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[19] 18 CFR § 292.403(b) provides for waivers of certain FERC rules, including the avoided cost rule, on State commission petition. Commissions have expressly declined utility requests that they petition. *E.g.*, Fla. PSC Order No. 9970, April 22, 1981.

[20] NRRI, *op cit.*, note 13, *supra* p. 22.

[21] *Batterson* v. *Francis*, 432 U.S. 416, 426 (1977). *See also Vermont Yankee Nuclear Power Corp.* v. *Natural Resources Defense Council*, 435 U.S. 519, 558 (1978); *Permian Basin Area Rate Cases*, 390 U.S. 747, 791-792 (1968).

CONCLUSION

For the reasons stated, the decision of the court of appeals in this case should be reversed insofar as the decision holds any provisions in 18 C.F.R. Part 292 invalid.

Respectfully submitted,

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